

Lease agreements containing purchase options that are equal to the fair market value of the tangible personal property at the end of the lease term are considered true leases, and the lessors incur Use Tax liability on their cost price of tangible personal property purchased for rental purposes. See 86 Ill. Adm. Code 130.2010. (This is a GIL.)

March 19, 1999

Dear Ms. Xxxxx:

This letter is in response to your letter that we received December 2, 1998. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

COMPANY is an equipment leasing company operating throughout the United States and specializing in restaurant equipment leases. Please answer the following questions to aid us in paying our sales/use tax to your state in a correct and timely manner.

1. Are we required to pay the sales/use tax up front or on each lease payment (stream) on a fair market value (FMV) lease? Up front Stream
2. Are we required to pay the sales/use tax up front or on each lease payment (stream) on a lease with a fixed nominal amount due at the end of the lease (\$1 buyout)? Up front Stream
3. On a **sale-leaseback**:
 - A. If a restaurant owner purchases equipment and pays all of the taxes up front, how much time can lapse between the original purchase of the equipment and AMRESKO doing a **sale-leaseback** before additional tax is due? _____ months Can the equipment be in use during this time? Yes No
 - B. Does the answer to 3.A. remain the same if the **sale-leaseback** is a FMV? Yes No
If not, please explain.
 - C. Does the answer to 3.A. remain the same if the **sale-leaseback** is a \$1 buyout? Yes No
If not, please explain.
 - D. If the **sale-leaseback** is a FMV are the taxes due up front or on each lease payment (stream)? Up front Stream
Any exceptions to this?

- E. If the **sale-leaseback** is a \$1 buyout are the taxes due up front or on each lease payment (stream)? Up front Stream
Any exceptions to this?
4. Is there any exemption on equipment used in the processing or manufacturing of food for sale? Yes No
If yes, please explain.
5. Are there any other exemptions or exceptions that we should be aware of?

We are answering your questions in narrative form in order to provide a more complete description of the Illinois sales tax laws as applied to leasing transactions.

For general informational purposes we enclose a copy of 86 Ill. Adm. Code 130.2010, the Department's regulation that covers the taxation of leases. Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation and Use Tax purposes. Lessors are subjected to a Use Tax on their cost price or acquisition value of tangible personal property which they use by leasing in Illinois. The only exception is automobiles rented for one year or less.

True leases generally have no buy out provisions at the close of the leases. If buy out provisions do exist, they must be fair market value buy out options in order to maintain the character of the true leases. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See, 86 Ill. Adm. Code 130.220(a). As end users of tangible personal property located in Illinois, lessors incur Use Tax liability on their cost price of such property.

Under Section 130.2010(a), persons who purport to "lease" the use of property, but in fact sell such tangible personal property to nominal "lessees," are considered to be making conditional sales subject to Retailers' Occupation Tax. Such would be the case when the agreements contain nominal purchase options at the end of the lease term. In these situations Retailers' Occupation Tax is due on all the payments received by the "lessors." Interest or finance charges may be excluded from gross receipts if the books of the retailers ("lessors") clearly reflect the amounts of the payments attributable to financing. See 86 Ill. Adm. Code 130.420, enclosed.

Regarding sale/leaseback situations, typically customer A purchases equipment from retailer B, and then sells it to lessor C who leases the equipment back to customer A. Customer A has paid tax when purchasing the equipment in the first transaction under a taxable retail sale and the second transaction (customer A's sale to lessor C) is a nontaxable occasional sale so long as A is not otherwise in the business of selling like-kind property. The third transaction (the leaseback of the equipment from lessor C to customer A) is not taxable because, as noted above, Illinois does not impose a sales/use tax on rental receipts with the exception of automobiles rented for a period of one year or less.

In general, no special documentation is required for any of the transactions. In transaction 1 (sale from retailer B to customer A), retailer B would include the gross proceeds from its sale to customer A on its monthly sales tax returns and customer A would retain an invoice showing it paid tax to retailer B. In transaction 2 (sale from customer A to lessor C), it may be wise to document, on the invoice to lessor C, the fact that customer A is not otherwise in the business of selling like-kind equipment and that the sale is a nontaxable occasional sale. Transaction 3 (leaseback from lessor C to A) requires no documentation because rental receipts under true leases are not subject to Illinois sales tax liability (again, except automobiles rented for one year or less).

The sale/leaseback transaction is not generally used with a conditional sale because there is no statutory mechanism to provide a credit for tax customer A properly paid in its previous purchase from B. If a sale/leaseback is used in conjunction with a conditional sale, tax will be due when lessor C conditionally sells the equipment back to A. To avoid this result A would need to lease the equipment from C under a true lease rather than a conditional sale.

Enclosed is a copy of 86 Ill. Adm. Code 130.330 concerning the Manufacturing Machinery and Equipment Exemption. In general, the Retailers' Occupation Tax does not apply to sales of machinery and equipment used primarily in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease.

Please be advised the use of machinery or equipment in the preparation of food and beverages by a retailer for retail sales, i.e., restaurants, food service establishments, etc., is an activity that is generally not considered to be manufacturing. See 86 Ill. Adm. Code 130.330(d)(4)(I).

Other exemptions under Illinois sales tax law include ones for machinery or equipment used in production agriculture, graphic arts, coal mining and oil drilling. If you wish to order a complete copy of the Illinois Sales Tax Rule Book you can remit \$6.50 to this office, attention Margaret Forth.

I hope this information is helpful. The Department of Revenue maintains a Web site which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Karl Betz
Associate Counsel

KB:msk
Enc.